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REFORM OF SOVIET INDUSTRIAL MANAGEMENT: A STATUS REPORT

CENTRAL INTELLIGENCE AGENCY

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REFORM OF SOVIET INDUSTRIAL MANAGEMENT: A STATUS REPORT

The Soviet regime is cautiously and deliberately implementing the reforms in the management of industry proposed by Premier Kosygin at the September 1965 plenum of the CPSU's central committee. In the ensuing eight months, the regime has completed changes affecting over-all administration--principally, by abolishing Khrushchev's system of regional economic councils and re-establishing the industrial ministries--and has begun to introduce the changes proposed for the management of individual industrial enterprises.

The changes in enterprise management to be accomplished between 1966 and 1968 have three main aspects. Increased use of financial incentives is to induce enterprises to raise efficiency and improve the quality of their output. Directors will have more freedom to manage their plants and to respond to the changed incentives. Finally, the reform of industrial wholesale prices will facilitate the operation of the financial incentives.

The benefits derived from the reforms as they now are designed are not likely to be great. For the most part the over-all administrative changes merely restore the pre-1957 structure of administration. As for the new system of enterprise management, the inducements now offered have little potential for improving efficiency and quality of output. Moreover, continued detailed central planning of output and supply, together with the lack of flexible prices, will hamper whatever efforts the enterprises do make to improve their efficiency.

Progress on Implementation

Since September, progress on implementing the reforms has been registered in several areas. In October, a revised statute codified the new freedoms and responsibilities of enterprises. Provisional instructions published in February detailed the operation of plants and factories under the new system. By 1 July, approximately 240 enterprises will be in the new system--43 in the first quarter of the year and about 200 in the second.

The new enterprise statute, which apparently applies only after a plant has transferred to the new system, permits managers to make many decisions on internal operation that formerly were

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PLANNING ASSIGNMENTS TO SOVIET ECONOMIC ENTERPRISES: OLD AND NEW SYSTEMS COMPARED

OLD SYSTEM LEVIED ASSIGNMENTS COVERING:		NEW SYSTEM LEVIES ASSIGNMENTS COVERING:
MOST IMPORTANT ASSIGNMENTS (Must be fulfilled before bonuses can be paid to enterprise managers)		
Cost per unit of output	Replaced By	Total profits
Gross value of output	Replaced By	Total value of sales
Physical volume of output of principal products	No Change	Physical volume of output of principal products
Total wages paid	No Change	Total wages paid
Output delivery schedules	Dropped	
Labor productivity	Dropped	
	Added	Profitability (total profits as a percent of total value of fixed and working capital)
OTHER MAJOR ASSIGNMENTS		
Total profits	Transferred To MOST IMPORTANT Category Above	
Total number of workers by grade and type	Dropped	
Amounts and sources of materials and equipment	No Change	Amounts and sources of materials and equipment
New investments in fixed capital	Changed To	Major investments in fixed capital
Introduction of new products	No Change	Introduction of new products
Introduction of new production processes	No Change	Introduction of new production processes
Payments to state budget for profits tax and amortization of fixed capital	Changed To	Payments to state budget for charge for use of capital, repayment of credits for major investments in fixed capital and part of amortization of fixed capital
MINOR ASSIGNMENTS		
Detailed assignments (20 to 30 in number) covering such matters as volume of output, cost of specific products, and productivity of labor and equipment in producing specific products	Dropped	

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made for them by their superior agencies. These decisions include, for example, the number of workers and the size of inventories of materials and semifinished goods. The provisional instructions put out in February list both the goals still to be determined by the central authorities under the new system and the specific details of the revised incentives.

At least the first 43 enterprises met stringent criteria in order to qualify for selection. Selected plants had to earn sufficient profits to be able to pay an interest charge on their capital. They also needed to have available sufficient additional funds to meet interest charges on short-term loans, provide for managerial bonuses, and make other payments required from profits under the new system. Other criteria include high quality of output, stable finances, and satisfactory administrative organization. The requirements also specified that the plant must have "agreements" with customers and suppliers, although such "agreements" are not the same thing as direct contracts, which have been used only in the light industries.

A special interdepartmental commission, headed by the State Planning Commission (Gosplan), is directing implementation of the reforms. Representatives of the Ministry of Finance, the state committees for labor and wages and for prices, and other central agencies sit on this commission. Introduction of the reforms in individual enterprises, however, is the responsibility of the industrial ministries to which the plants are subordinate.

Future Implementation

A tentative schedule for introducing new prices and for transferring the remainder of industry to the new system was announced last March by the chairman of Gosplan. Beginning 1 July, whole branches of industry will switch to the new system; this presumably means that the present strict criteria for the transfer of individual enterprises will be relaxed. A number of minor branches of the food industry are to lead the changeover because no price changes are to be made in them.

In late 1966 and early 1967, most of light industry and the food industry will convert after new prices are established--possibly on 1 October 1966. According to Kosygin at the recent party congress, the enterprises in question employ nearly a third of all industrial workers. The remainder of industry will switch in two further stages, on 1 July 1967 and on 1 January 1968, again apparently after the planners have set new prices.

Main Features of New System

The provisional instructions impose on enterprises new criteria by which their performance will be judged. These criteria include: total profits, total value of sales, and profitability. The Soviets define profitability as a percentage of total profits to the total of fixed and working capital. Moreover, under the new system enterprises must pay the State Bank a new charge on the use of fixed and working capital --now set at three to six percent--as well as higher interest charges for short-term loans than in the past. They now also must repay credits advanced from the state budget for reconstruction and expansion instead of receiving what were, in effect, grants for these purposes. All of these payments will come from enterprise profits.

For each plant, central assignments of goals for profits and profitability replace the previous assignment governing costs, which induced managers to reduce their production costs at the expense of quality. The new assignment specifying total value of sales replaces the former assignment of gross value of output. The latter had led plant managers to emphasize volume at the expense of quality.

(The table on page two compares the old and new system of plans assignments to Soviet enterprises.)

Increased Freedom for Enterprises

The new freedoms granted under the revised enterprise statute permit the enterprise managements (a) to determine for themselves the total number of employees they need, (b) to specify the composition of their working capital (materials and tools), (c) to determine more freely their own needs for fixed capital, (d) to dispose of unneeded fixed capital such as underemployed machinery, without the express permission of superior agencies, and (e) to borrow more freely from the State Bank. Under the provisional instructions, moreover, the number of assignments the central authorities give an enterprise are reduced from 30 or 40 to about ten.

The central authorities retain the right to decide, however, such crucial matters as how many of each of the enterprise's principal products will be made (the output assortment), total wages paid, the amounts and sources of materials and equipment, new investment in fixed capital, and the introduction of new products and new production methods. Central authorities also continue to set basic wage rates and the wholesale prices of products.

Bonuses for Managers

The provisional instructions specify that bonuses for industrial managers now are to be financed from profits rather than from the wage fund, as in the past. However, the amounts set aside for bonuses are determined by the size of the total wage bill, the increase in sales, and the level of profitability attained by the enterprise. Actual payment of bonuses, moreover, will depend on whether the manager has fulfilled his quota for sales, profits, profitability, and volume of output; whether he has avoided overspending on wages; and whether the enterprise has paid off capital charges and interest on short-term loans.

The linking of managerial bonuses to enterprise profitability is the most significant innovation of the new bonus system. The sales component of the bonus--carried over from the old system--links the amount of bonus payment to the enterprise's performance in a current year as compared to its past performance. The new profitability component of the bonus is based on the enterprise's performance compared to other, similar enterprises, thereby introducing a competitive element. Failure to compute bonuses on this basis under the cost reduction system, which has been in effect since 1959, is an important reason for the failure of the old system to bring about significant increases in enterprise efficiency.

Production Development Fund

The provisional instructions also provide for the establishment at each plant of a new enterprise fund--the "production development fund"--to be used for plant modernization and improvement at the initiative of the enterprise. The fund is financed partly out of profits and partly out of funds for amortization of fixed capital that formerly were returned to the state budget. The intent of the fund is to make it possible for plant managers to exercise their initiative in making improvements not specified in their plan assignments. The manager must include in his plans submitted to the central authorities, however, proposals for the purchase of equipment from this fund, and receive the equipment through the normal channels of centrally controlled supply.

Reform of Industrial Wholesale Prices

No details on the reform of industrial wholesale prices are yet public. In his speech to the September 1965 plenum, Kosygin gave the newly formed State Committee for Prices responsibility for submitting recommendations for determining new industrial wholesale prices by 1 January 1966. Although the details of these recommendations were never published, the committee chairman released some general statements on them early in January, which indicated the three main features of the price reform:

(1) The revised industrial wholesale prices are to provide a profit margin sufficient to cover capital charges, bonuses, and other payments from enterprise profits. The cost for most products is to be the average for all enterprises producing a given product. The lower profits of high-cost enterprises could result in lower managerial bonuses, but lower profits may be offset by fixing a lower capital charge for plants in a disadvantageous cost position.

(2) The price reform is to provide inducements to enterprises to produce "technically progressive" products by establishing higher prices for new products. The prices of new products will be high in relation to production costs, and then lower after a fixed interval of time, when these goods are "no longer technically progressive."

(3) The reform seeks to encourage enterprises to improve quality by authorizing price increases to cover the increased cost of high-grade output. Such price increases were permitted only infrequently in the past. Corresponding reductions in prices are to be made when enterprises fail to maintain quality standards.

The fate of recent proposals by prominent economists to introduce some flexibility in pricing is unknown. These economists have suggested retaining central fixing of prices for only a few key products and permitting the prices of other products to fluctuate between limits determined by the state.

Unsettled Issues

Neither the enterprise statute nor the provisional instructions have made any clear statements about the specific role that direct contracts between enterprises and their customers are to play under the reform or about the changes in the central planning of output and supply that may be required to carry out the reforms. The enterprise statute provided that consumer goods enterprises would base their output plans on orders from the trade network and urged that all other plants enter into direct contracts. The provisional instructions, however, failed to mention how this was to be implemented in enterprises transferring to the new system.

Kosygin alluded briefly to these questions in September, when he stated that as the extent of direct contracts increases, the detail with which central output plans are compiled could be reduced. He also noted that the present central rationing of industrial materials and equipment could eventually be abolished, and supplies could be freely distributed by the wholesale trade network.

The failure to clarify these issues or to publish the details of the price reform have led Soviet economists to give varying interpretations of the over-all impact of the reforms. Some liberal economists, such as Liberman, Birman, and Pugachev, have viewed the reforms as resulting in a substantial movement toward the introduction of market forces. In their view, the reforms will sharply reduce tautness of planning, enterprises will compete with one another for orders, and industrial wholesale prices will be able to fluctuate, albeit within limits set by the state. These economists also state that detailed central plans for the physical assortment of output and for supply will be abolished.

Most of the more conservative economists do not interpret the changes in this light. To them, the role of direct contracts--apart from consumer goods--is approximately the same as that experimented with in heavy industry prior to the September plenum: they are to be used to determine the details of delivery of products after the specifications, supplier, purchaser, and prices have been set centrally. Any changeover from central rationing of industrial materials and equipment to free distribution through wholesale trade channels will occur only after there has been a sharp improvement in their availability. Moreover, this will apply only to enterprises producing commodities whose supply has caught up with demand.

Similarly, any elimination of central planning of the product "mix" for these commodities will await the abolition of central rationing of industrial materials. The Soviet leadership apparently shares this conservative view. For example, the new five-year plan (1966-70) calls for a sharp improvement in the availability of industrial materials and equipment, to provide the basis for an eventual transfer to freer distribution through wholesale trade channels, presumably after 1970.

Prospects

The benefits from Kosygin's program of economic reform as presently constituted are likely to prove disappointing. Fragmentary reports on the details of the system as applied to the 43 enterprises transferred to it in the first quarter of this year suggest that they fail to give sufficient stress to the improvement of efficiency. In many cases, attainment of sales target influenced the amount of managerial bonuses paid more than did the level of profitability. For example, the profitability of one enterprise dropped during the quarter as a result of improvements in quality not compensated by price increases, but substantial bonuses still were paid because the enterprise attained a large increase in sales.

The results in the 43 enterprises also indicated an unwillingness to permit payment of the capital charge to infringe unduly on managerial bonuses. The provisional instructions, for example, called for a six-percent capital charge, but the actual charge levied on less profitable enterprises during January-March 1966 was set as low as three percent.

The affected enterprises now are theoretically free to increase the efficiency of their operations, but the Soviet bureaucracy may nullify this freedom before it becomes fully effective. Recent press articles by Birman and other liberal economists express this fear. No evidence exists, for example, that a significant number of workers was discharged by the first 43 enterprises, although the enterprise statute specifically allows them to do so. In another instance of frustrated efficiency, at least one of the 43 enterprises sought to sell unneeded equipment but was unable to find a buyer because the State Bank refused to lend funds for its purchase.

Perhaps the most important impediment to the improvement of efficiency under the new system is the continuation of central controls over both the level and physical assortment of output and the supply of materials and equipment. In the absence of flexible prices, central assignments for total sales and for the output of specific products will not be consistent with maximum profits. Thus, enterprises may find it difficult to meet their sales and production assignments and still raise profits. If the incentives to increase profits are made strong, assortment and sales plans could be unfulfilled, and instances of excess productive capacity may appear. If, on the other hand, the incentives to raise profits are weak, the physical assortment and sales plans could be fulfilled at the expanse of efficiency.

In addition, continued central controls over (a) plant expansion and reconstruction, (b) the introduction of new products and new technological processes, and (c) the sources and amounts of materials and equipment will work against enterprise efforts to improve efficiency. Plants may attempt to resist centrally imposed expansion plans or assignments for introducing new technology as being unprofitable, or worse, they may accept the plans at the expense of efficiency.

Failure of the reform program to produce appreciable gains in economic efficiency and quality of output during the next few years will generate increasing pressures for a more decisive movement toward the use of market forces in the Soviet economy. Liberal Soviet economists, in their warnings that the present program may be in danger of being sabotaged by conservative bureaucrats, seem to be building their case for such a movement. The increasing institutionalization of Soviet society and the continued development of an entrenched bureaucracy, however, suggest that reforms will continue to be piecemeal and relatively ineffective. The time for a sweeping reordering of economic reality--as opposed to intellectual blueprints--is apparently not yet at hand.

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